

was reasonable.⁶² The Commission dismissed upper band limits of less than 5% as “nothing more than an attempt to freeze relative LEC rates.”⁶³ The Commission also found that the 5% upper limit was a mechanism that “protected against rapid and substantial changes in the price of access.”⁶⁴ For these reasons, there is no basis for any reduction in the upper flexibility limits.

AT&T also argues that the upper SBI limit provides only a “limited check” on a LEC’s ability to increase prices after they have been decreased. AT&T claims that a LEC can “maneuver” prices to retain the same upward pricing flexibility that it had for the band before price decreases.⁶⁵ This maneuvering, however, assumes that there are no PCI changes, and involves pricing back to the original aggregate SBI level prior to an annual filing. AT&T cites NYNEX for having “pursued the tactic” of increasing rates just prior to the 1995 annual filing.⁶⁶ What AT&T is citing is simply the workings of price caps, and the fact that upward flexibility, or “headroom” (that is, the difference between the API and PCI) can be lost when bands are re-established in the

⁶² See Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990) at para. 224, where the Commission stated that “We believe the 5 percent band is a reasonable amount of upward pricing [flexibility] to associate with the no suspension zone. A 5 percent upper band ensures LECs have some ability to adjust prices to changing market conditions, at the same time protecting ratepayers from substantial changes in service rates. The upper band is also consistent with our decision to move forward with a price cap system that looks, in the first instance, to LEC prices, instead of relying on fully distributed costs.”

⁶³ *Id.* at para 225.

⁶⁴ *Id.* at para 202.

⁶⁵ See AT&T at pp. 43-44.

⁶⁶ See AT&T at n. 89.

annual filing. AT&T is well aware of the workings of price caps. In their June 13, 1995 Petition for Waiver Relating to the "Residential Index," AT&T requested a waiver of Commission's rules in order to retain existing "headroom" for its residential price index, without having to increase rates for one day, only to subsequently lower them. The flexibility of pricing up to the upper SBI and PCI limits cited by AT&T is nothing more than what was provided to AT&T in its own price cap plan.

Some companies oppose any additional downward pricing flexibility, basing their opposition on concerns about predatory pricing. In the regulatory framework proposed by NYNEX, additional downward pricing flexibility would be allowed as a LEC opened its markets to more competition and as CLECs developed a competitive presence in a particular market. The phased-in approach proposed by NYNEX would encourage competitive responses, while limiting concerns about predatory pricing.

Since additional downward flexibility would be phased-in as markets were subject to competition, competitive forces would limit a LEC's ability to recover rate decreases for some services with increases to other services. In fact, as more competition is introduced into a market, there should be fewer restrictions of any kind for either upward or downward pricing. As service baskets become subject to competition, the Commission should allow both increased lower band limits, as well as some increased upward flexibility.

One notable exception to those opposing the elimination of lower band limits is GSA. GSA states that while, in concept, there is a risk that carriers would increase rates where demand is inelastic, a careful review of the specific proposals in the *Second Further Notice* reveals no instance where this danger is imminent. "While there is already justification for greater downward pricing flexibility in the absence of competition, the presence of competition increases that justification."⁶⁷ GSA also does not support limiting price increases to 1% within service categories where there are rate reductions, because it "is likely to have a severe dampening effect on the willingness of the carriers to offer price reductions," by virtually guaranteeing that every price reduction would generate a net loss of revenue to the LECs.⁶⁸ GSA argues that the concern about offsetting predatorily low prices with increases in other prices is overstated. They state that "[A]ny LEC must know that it stands very little likelihood of eliminating competitors through below-cost pricing. As the number and resources of its competitors grow, the more likely result of such pricing will be to leave the LEC with the dominant market share of a loss operation, hardly a happy outcome. Similarly, the likely effect of above-cost pricing by the LEC will be to hasten the challenge by its competitors to its most profitable services."⁶⁹ GSA is correct in observing that the danger of predatory pricing is greatly overstated, and that a more likely result of limits on upward pricing flexibility is

⁶⁷ GSA at pp. 4-6.

⁶⁸ *Id.* at p. 7.

⁶⁹ *Id.*

that price competition would be discouraged. For these reasons, the Commission should consider increasing the amount of upward flexibility as competition increases.

B. The Commission Should Allow The LECs To Consolidate Price Cap Baskets And Service Categories As Competition Develops.

The *Second Further Notice* sought comments on whether the development of competition for particular services would require adjustments to the current basket structures or consolidation of service categories.⁷⁰ While the LECs suggest changes to the current baskets and service categories, other commenters support retention of the existing structure on the basis that there is not enough competition to warrant changes.⁷¹ No commenters, however, appear to argue that basket changes may not be appropriate when competition does develop.

NYNEX believes that, even if there were no competition now, which certainly is not the case in NYNEX's operating territory, the Commission should give the industry notice about the changes to the price cap system that will apply as services and areas become subject to competition. In its Comments, NYNEX outlined changes in baskets and service categories that would be appropriate as competition develops.

A few non-LEC commenters specifically address the question of combining existing service categories, such as those for DS1 and DS3 services.

⁷⁰ *Second Further Notice* at para. 86-95.

⁷¹ *See, e.g.,* Ad Hoc at pp. 19-20; AT&T at pp. 45-49; NCTA at pp. 27-28.

CompTel continues to oppose this combination, because they maintain that it would have implications for DXC competition.⁷² NCTA, Ad Hoc, and Time Warner would allow service category consolidations if cross-elasticities could be demonstrated.⁷³

Few parties would argue that DS1 and DS3 are not cross-elastic services. As substitute services, they should be combined in one service category for pricing. Although CompTel implies that DS3 services are more competitive than DS1 services, most major LEC competitors, as well as DXCs, offer both DS1 and DS3 services. The current DS1/DS3 subcategory restrictions should be eliminated so that competition in the high capacity services market could determine the most efficient pricing relationship. When competitors are present in a transport market, there is no reason to maintain the current DS3 and DS1 services sub-categories, which would only stand in the way of efficient, market-based pricing.

VIII. The Commission Should Place Operator Services In The Information Services Category.

Few non-LEC parties commented on the issue of where to place operator services and call completion services in the price cap system.⁷⁴ AT&T advocates placing these services in a new service category within the Traffic Sensitive ("TS") basket with 5% limits, and including directory assistance ("DA")

⁷² See CompTel at pp. 35-36.

⁷³ See NCTA at pp. 27-28; Ad Hoc at p. 20; Time Warner at p. 24.

⁷⁴ See *Second Further Notice* at paras. 96-102.

completion services with DA services in the existing information service category.⁷⁵ Time Warner proposes placing operator services in one service category and call completion services in another category within the TS basket.⁷⁶ MCI proposes placing operator services and call completion services in one service category.⁷⁷ The LECs generally oppose any new service categories for operator services or call completion services.⁷⁸

NYNEX supports the combination of all operator services with directory assistance services in the information service category. Functionally, these services are similar in that they are ancillary to primary switched access. Given the price cap objective of promoting efficient and flexible LEC pricing, any subcategorization below this level should not be imposed unless absolutely necessary.

⁷⁵ See AT&T at pp. 52-55.

⁷⁶ See Time Warner at p. 25.

⁷⁷ See MCI at p. 20.

⁷⁸ See USTA at p. 38.

IX. Conclusion.

The NYNEX proposal for an adaptive regulatory model would meet the objectives of the Commission in this proceeding and in other proceedings for a coordinated set of changes in regulatory policies as the local exchange and interstate access markets become subject to competition. The Commission should adopt the NYNEX model as part of a comprehensive review of its regulatory policies.

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CERTIFICATE OF SERVICE

I hereby certify that copies of this pleading were mailed this date, first class postage prepaid, upon the persons listed on the attached service list.



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